

Message Text

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ACTION EUR-12

INFO OCT-01 EA-09 NEA-10 IO-11 ISO-00 AID-05 CIAE-00 EB-07

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SP-02 CIEP-02 LAB-04 SIL-01 OMB-01 NSC-05 SS-15

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FM AMEMBASSY LONDON

TO SECSTATE WASHDC 8728

INFO AMEMBASSY BERN

AMEMBASSY BONN

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AMEMBASSY COPENHAGEN

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UNCLAS SECTION 01 OF 03 LONDON 01806

DEPARTMENT PASS TREASURY AND FRB

E.O. 11652: L/A

TAGS: ECON, UK

SUBJECT: ECONOMIC DEVELOPMENTS FOR THE PERIOD JANUARY 29
THROUGH FEBRUARY 4, 1976

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SUMMARY. THE GOVERNMENT RODE OUT A SHARP DEBATE IN PARLIAMENT OVER RISING UNEMPLOYMENT. ITS REPEATED CONTENTION THAT THE ECONOMY HAS SHIFTED GEARS WAS BORNE OUT IN SURVEYS OF BUSINESS INTENTIONS PUBLISHED BY THE FINANCIAL TIMES AND THE CONFEDERATION OF BRITISH INDUSTRY (CBI). BOTH REPORT GROWING CONFIDENCE AMONG INDUSTRIALISTS THAT A RECOVERY IS BEGINNING. THE 0.5 PERCENT DROP IN THE BANK OF ENGLAND'S MINIMUM LENDING RATE HAS ADDED TO THIS OPTIMISM WHILE THE RECENT DRAWING FROM THE IMF HAS SHOWN UP AS A SHARP INCREASE IN U.K. INTERNATIONAL RESERVES. END SUMMARY

1. BUSINESS CONFIDENCE CONTINUES TO IMPROVE. THE FINANCIAL TIMES MONTHLY SURVEY OF BUSINESS OPINION FOR JANUARY SHOWS GROWING OPTIMISM ABOUT THE GENERAL ECONOMIC CLIMATE. ONLY 12 PERCENT OF RESPONDENTS WERE LESS OPTIMISTIC ABOUT THEIR COMPANYS PROSPECTS THAN THEY WERE FOUR MONTHS EARLIER. THIS IS LESS THAN HALF OF THE NOVEMBER SURVEY TOTAL. FULLY 41 PERCENT OF THE REMAINING RESPONDENTS WERE MORE OPTIMISTIC, A RISE OF 10 PERCENTAGE POINTS SINCE NOVEMBER. AS WOULD BE EXPECTED, DURING A PERIOD WHEN THE ECONOMY IS CHANGING DIRECTION, NOT ALL INDICATORS ARE UNIFORMLY POSITIVE. THE TREND OF NEW ORDERS SHOWED SOME DECLINE OVER THE OCTOBER-JANUARY PERIOD AND NEARLY SIX OF TEN FIRMS REPORTED THEY WERE OPERATING BELOW PLANNED CAPACITY. HOWEVER, REPLIES TO QUESTIONS ON THE MOVEMENT OF RAW MATERIALS AND FINISHED GOODS INVENTORIES SHOW AN INCREASING BELIEF THAT STOCKS WILL EITHER STAY AT PRESENT LEVELS OR INCREASE IN THE YEAR AHEAD. ON RAW MATERIALS STOCKS, 35 PERCENT OF RESPONDENTS EXPECTED AN INCREASE WHILE 18 PERCENT FORESAW A DECLINE. THE COMPARABLE FIGURES FOR THE DECEMBER SURVEY WERE 26 AND 14 PERCENT RESPECTIVELY. ON FINISHED GOODS, 23 PERCENT EXPECTED AN INCREASE IN STOCKS WHILE 16 PERCENT ANTICIPATE A DECLINE. THE DECEMBER FIGURES WERE 18 AND 17 PERCENT RESPECTIVELY.

2. SEVEN OF EVERY EIGHT RESPONDENTS CITED CONTINUING WEAKNESS IN DOMESTIC DEMAND AS THE PRINCIPAL FACTOR CURRENTLY AFFECTING PRODUCTION. THIS FIGURE HAS SHOWN LITTLE CHANGE SINCE LAST AUTUMN. HOWEVER, THE NUMBER OF RESPON-

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DENTS ANTICIPATING IMPROVED EXPORTS HAS RISEN TO 72 PERCENT, A SIGNIFICANT RISE OVER THE NOVEMBER FIGURE OF 62 PERCENT.

3. WITH RESPECT TO PRODUCTION COSTS, HALF OF ALL RESPONDENTS EXPECT WAGES TO RISE BY 10 TO 14 PERCENT WHILE 33 PERCENT BELIEVE A 15 TO 19 PERCENT INCREASE MORE LIKELY. UNIT COST INCREASES OF 5 TO 14 PERCENT ARE FELT LIKELY BY

38 PERCENT WHILE INCREASES IN THE 15 TO 19 PERCENT RANGE
ACCOUNT FOR ANOTHER 39 PERCENT OF RESPONDENTS. WHILE THE
PERCENTAGE OF THOSE EXPECTING TO INCREASE HIRING ROSE FROM
9 PERCENT IN DECEMBER TO 16 PERCENT, THOSE RESPONDENTS EX-
PECTING TO SHED LABOR ALSO INCREASED FROM 31 PERCENT IN

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INFO OCT-01 EA-09 NEA-10 IO-11 ISO-00 AID-05 CIAE-00 EB-07

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DECEMBER TO 35 PERCENT. INVESTMENT INTENTIONS IN REAL TERMS SHOWED LITTLE CHANGE FROM DECEMBER WITH 35 PERCENT EXPECTING TO INCREASE INVESTMENT WHILE 39 PERCENT EXPECTED TO REDUCE INVESTMENT EXPENDITURE. FINALLY, HALF OF ALL UNCLASSIFIED

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RESPONDENTS EXPECTED PROFITS TO IMPROVE OR REMAIN THE SAME WHILE 42 PERCENT EXPECTED THEM TO DECLINE.

4. CBI BUSINESS SURVEY REVEALS CAUTIOUS OPTIMISM. IN ITS QUARTERLY SURVEY OF BUSINESS TRENDS, THE CONFEDERATION OF BRITISH INDUSTRY REPORTS THAT A MOOD OF CAUTIOUS OPTIMISM APPEARS TO BE TAKING ROOT IN MANUFACTURING INDUSTRY. IN REPLY TO A QUESTION ON THE CURRENT GENERAL ECONOMIC OUTLOOK COMPARED WITH THAT OF LAST OCTOBER, 22 PERCENT REPLIED THAT THEY WERE MORE OPTIMISTIC, 66 PERCENT HAD NOT CHANGED THEIR VIEW AND 12 PERCENT WERE LESS OPTIMISTIC. THE OCTOBER FIGURES WERE 12, 58 AND 30 PERCENT RESPECTIVELY. FOR THE FIRST TIME IN TWO YEARS THERE WAS A POSITIVE BALANCE BETWEEN THOSE EXPRESSING MORE RATHER THAN LESS OPTIMISM. CONFIRMING THE RESULTS OF THE FINANCIAL TIMES SURVEY, THE REAPPEARANCE OF SOME DEGREE OF CONFIDENCE ABOUT THE FUTURE WAS TEMPERED BY RESPONSES ON CURRENT LEVELS OF OUTPUT, EMPLOYMENT AND COSTS. NEARLY 4 OUT OF 5 OF THE 2,000 FIRMS COVERED BY THE SURVEY REPORTED THAT THEY WERE OPERATING BELOW CAPACITY, 58 PERCENT EXPECTED TO MAINTAIN CURRENT LEVELS OF EMPLOYMENT AND 31 PERCENT ANTICIPATED A FURTHER REDUCTION IN THEIR WORK FORCES. IN FACT, THE SURVEY POINTS TO A DECLINE OF JOBS IN MANUFACTURING EMPLOYMENT BETWEEN DECEMBER 1975 AND APRIL 1976. UNIT COSTS ARE EXPECTED TO CONTINUE RISING BY 5 OF EVERY 6 RESPONDENTS.

5. ON THE BRIGHTER SIDE, 36 PERCENT OF RESPONDENTS REPORT RISE IN THE VALUE OF NEW ORDERS OVER THE PAST 4 MONTHS AND 37 PERCENT EXPECT FURTHER INCREASES OVER THE COMING FOUR MONTHS. THOSE REPORTING DECLINES AMOUNTED TO 30 PERCENT OF RESPONDENTS WHILE ONLY 14 PERCENT EXPECTED A FURTHER DROP IN THE VALUE OF ORDERS OVER THE NEXT FOUR MONTHS. JUST OVER HALF OF ALL RESPONDENTS EXPECTED A RISING TREND IN THE VALUE OF OUTPUT OVER THE NEXT FOUR MONTHS WITH JUST 11 PERCENT FORESEEING A DECLINE. MOST INTERESTING WERE THE REPLIES TO A QUESTION ASKING FOR FACTORS LIKELY TO LIMIT OUTPUT OVER THE NEXT FOUR MONTHS. WHILE 85 PERCENT OF THE FIRMS CITED DEPRESSED ORDERS OR SALES, 10 PERCENT CITED A SHORTAGE OF SKILLED OR OTHER LABOR. THIS COULD BE AN EARLY SIGN OF A POTENTIAL BOTTLE-

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NECK AS THE RECOVERY GATHERS MOMENTUM.

6. THE CLOSELY WATCHED INVESTMENT INTENTIONS RESULTS ALSO PROVIDE GROUNDS FOR SOME OPTIMISM. WHILE THE BALANCE OF INTENTIONS TO INVEST IN BUILDINGS WAS STILL NEGATIVE WITH 22 PERCENT INTENDING TO AUTHORIZE MORE INVESTMENT AND 34 PERCENT LESS, THERE HAS BEEN A DEFINITE SWING IN THE DIRECTION OF MORE INVESTMENT. WITH REGARD TO INVESTMENT IN PLANT AND MACHINERY, THE BALANCE HAS SHIFTED FROM NEGATIVE TO POSITIVE WITH 38 PERCENT EXPRESSING AN INTENT TO INCREASE SUCH INVESTMENT COMPARED WITH 28 PERCENT INTENDING TO REDUCE IT. THE OCTOBER SURVEY RESULTS WERE 25 PERCENT AND 40 PERCENT RESPECTIVELY FOR PLANT AND EQUIPMENT AND 13 PERCENT AND 44 PERCENT FOR BUILDINGS.

7. TURNING TO EXPORT PROSPECTS, 32 PERCENT OF RESPONDENTS WERE MORE OPTIMISTIC COMPARED WITH 13 PERCENT WHO EXPRESSED A PESSIMISTIC VIEW. THE TREND OF NEW EXPORT ORDERS HAS BEEN RISING OVER THE PAST FOUR MONTHS, AND 40 PERCENT OF RESPONDENTS EXPECT THIS TO CONTINUE WHILE JUST 15 PERCENT TAKE THE OPPOSITE VIEW.

8. BROKERS FORECAST 2 PERCENT GROWTH IN 1976. THE BROKERAGE HOUSE OF PHILLIPPS AND DREW IS REPORTED TO HAVE FORECAST GROWTH RATE OF 2 PERCENT FOR THE BRITISH ECONOMY IN 1976 FOLLOWED BY A 4 PERCENT RISE IN 1977. THE FIRM LOOKED FOR A 12.5 PERCENT RATE OF PRICE INCREASE IN 1976 DECLINING TO 9.5 PERCENT IN THE FOLLOWING YEAR. UNEMPLOYMENT IS EXPECTED TO PEAK AT 1.5 MILLION IN 1976 BUT ONLY BEGIN TO IMPROVE IN 1977. BRITAIN'S PAYMENTS DEFICIT IS EXPECTED TO REMAIN AT 1.5 TO 2 BILLION POUNDS BOTH THIS YEAR AND NEXT. LOOKING AHEAD, TERMS OF TRADE ARE EXPECTED TO WEAKEN AND THE VOLUME OF IMPORTS TO RISE IN RESPONSE TO THE DOMESTIC RECOVERY WHILE EXPORTS FAIL TO KEEP PACE.

9. DAYS LOST TO STRIKES DECLINE SHARPLY IN 1975. THE NUMBER OF MAN-DAYS LOST TO STRIKES IN 1975 DECLINED TO THE LOWEST LEVEL SINCE 1968. AT 5.96 MILLION, THE NUMBER

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ACTION EUR-12

INFO OCT-01 EA-09 NEA-10 IO-11 ISO-00 AID-05 CIAE-00 EB-07

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OF DAYS LOST TO STRIKES WAS 60 PERCENT BELOW THE 1974

FIGURE WHEN THE TOTALS WERE SWOLLEN BY THE 3-MONTH MIN-

ERS' STRIKE. THE ACTUAL NUMBER OF WORK STOPPAGES DROPPED

FROM 2922 IN 1974 TO 2263 IN 1975 WHILE THE NUMBER OF

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WORKERS DIRECTLY INVOLVED IN SOME FORM OF STRIKE ACTIVITY FELL BY OVER 50 PERCENT FROM 1.63 MILLION IN 1974 TO 0.806 MILLION IN 1975.

10. OFFICIAL RESERVES. U.K. OFFICIAL RESERVES ROSE BY \$1,356 MILLION DURING THE MONTH TO \$6,785 AT THE END OF JANUARY. THIS RISE REFLECTS IN PART THE DRAWING BY THE U.K. OF \$1,174 MILLION FROM THE IMF OIL FACILITY PLUS ACCRUALS OF FOREIGN CURRENCY BORROWINGS BY THE PUBLIC SECTOR UNDER THE EXCHANGE COVER SCHEME OF \$167 MILLION. PRESS REPORTS STATE THAT U.K. AUTHORITIES APPEAR TO HAVE DECLARED A "CONSERVATIVE" ESTIMATE OF THE RESERVE LEVEL AT END-JANUARY IN ORDER TO IRON OUT FLUCTUATIONS CAUSED BY "SWITCHING" OF STERLING OIL PAYMENTS RECEIPTS DURING THE MONTH. IF THESE REPORTS ARE TRUE, IT WOULD INDICATE THAT RESERVES WERE IN FACT HIGHER THAN ACTUALLY REPORTED IN ORDER TO DAMPEN THE EFFECTS OF ANTICIPATED CURRENCY SWITCHING BY THE OIL PRODUCERS DURING FEBRUARY.

11. LOWER INTEREST RATES. WITH THE REDUCTION OF AN ADDITIONAL 1/2 PERCENT IN THE BANK OF ENGLAND'S MINIMUM LENDING RATE (MLR) THE DOWNTREND IN INTEREST RATES HAS ACCELERATED. RATES FOR PERSONAL BORROWING ARE NOW IN THE 12 TO 14 PERCENT RANGE AFTER REMAINING AROUND THE 16 PERCENT LEVEL FOR A FAIRLY SUSTAINED PERIOD. SINCE MID-NOVEMBER, THE MLR HAS BEEN REDUCED BY 2 PERCENTAGE POINTS TO A LEVEL NOT WITNESSED SINCE LAST JULY. THE CONTINUATION OF A BUOYANT GILT MARKET COMBINED WITH THE EASING OF RATES BOTH IN THE U.S. AND IN EUROPE HAS GENERATED AN AIR OF SPECULATION THAT FURTHER CUTS IN THE MLR ARE PROBABLE. THIS EXPECTATION HAS BEEN FUELED BY A SUBSTANTIAL DROP IN THE AVERAGE RATE ON U.K. TREASURY BILLS TO WHICH THE MLR IS LINKED. SEVERAL MARKET SOURCES SPECULATE THAT DOMESTIC INTEREST RATES ARE LIKELY TO CONTINUE TO FALL EVEN IF OVERSEAS RATES FIRM. THESE CONDITIONS WILL CONTINUE, IT IS REPORTED, UNTIL THERE IS A SUBSTANTIAL UPTURN IN PRIVATE SECTOR BORROWING OR SIGNS OF A NOTICEABLE IMPACT ON STERLING.

12. EXCHANGE RATE AND GOLD EFFECTIVE
DEPRECIATION

DATE	EXCHANGE RATE (\$)	PERCENT	GOLD
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1/28	2.0290	29.9	128.25
1/29	2.0300	29.9	128.50

1/30	2.0300	29.9	128.50
2/2	2.0295	30.2	130.50
2/3	2.0280	30.1	131.25

CHANGE 1/27-2-3 UP 0.0015 WIDENED 0.1 UP 4.75

13. FORWARD DISCOUNT ON STERLING

DATE	1 MONTH	3 MONTHS	6 MONTHS
1/28	0.83	2.55	4.57
1/29	0.90	2.62	4.67
1/30	0.87	2.55	4.60
2/2	0.85	2.55	4.55
2/3	0.75	2.45	4.45

CHANGE 1/27-2/3 DN 0.05 DN 0.10 DN 0.10

(ALL FIGURES IN CENTS)

14. EURODOLLAR INTEREST RATES

DATE	1 MONTH	3 MONTHS	6 MONTHS
1/28	5	5-3/8	6
1/29	5	5-1/4	6
1/30	5	5-1/4	5-7/8
2/2	5	5-3/8	5-7/8
2/3	5-1/4	5-3/8	6

CHANGE 1/27-2/3 DN 1/8 DN 1/8 UNCHANGED

15. LOCAL AUTHORITY DEPOSIT RATES

DATE	1 MONTH	3 MONTHS	6 MONTHS
1/28	10-1/8	10-1/16	10-1/16
1/29	10-3/16	10	10-1/16
1/30	10-1/8	9-3/4	9-13/16
2/2	10	9-5/8	9-3/4
2/3	9-3/4	9-9/16	9-5/8

CHANGE 1/27-2/3 DN 3/8 DN 1/2 DN 7/16

16. THE MINIMUM LENDING RATE WAS CUT BY 1/2 PERCENT TO
10 PERCENT ON FRIDAY, JANUARY 30.

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Disposition Event:
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